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RUEHSG/AMEMBASSY SANTIAGO PRIORITY 0085
RUEHRI/AMCONSUL RIO DE JANEIRO PRIORITY 2110
RUEHSO/AMCONSUL SAO PAULO PRIORITY 3106
RUEAIIA/CIA WASHINGTON DC PRIORITY
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RUEHC/DEPT OF LABOR WASHINGTON DC PRIORITY
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PASS USTR FOR DUSTR VERONEAU, AUSTR EISSENSTAT, SCRININ
WHA FOR WHA/BSC AND WHA/EPSC
E FOR THOMAS PIERCE,
PASS NSC FOR JOSE CARDENAS
PASS FED BOARD OF GOVERNORS FOR PATRICE ROBITAILLE
EX-IM BANK FOR MICHELE WILKINS
TREASURY FOR ALICE FAIBISHENKO
USDOC FOR ALEXANDER PEACHER AND JOHN ANDERSEN
USCINCSO FOR POLAD

E.O. 12958: N/A

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SUBJECT: SCENESETTER: USTR AMBASSADOR VERONEAU'S JANUARY 26
VISIT

Introduction and Summary

¶1. (SBU) Embassy Buenos Aires warmly welcomes your January 26 visit to meet with the Ministers of Economy and Foreign Affairs and with members of the U.S. business community. Your arrival, immediately following your FTA consultations in Chile and your TIFA signing in Uruguay, will spark considerable interest from local media and from GoA trade officials. Both the Ministries of Economy and Foreign Affairs have expressed a strong interest in using your visit as a platform to re-launch regular senior level talks via our Bilateral Commission on Trade and Investment that last met in October 2003.

¶2. (SBU) GoA officials will be eager to review with you Argentina's participation in the January 18-19 Mercosur Summit and to present their vision for enhanced hemispheric economic integration via an expanded Mercosur. They will likely seek assurances that your TIFA signing with Uruguay does not represent a USG move to fragment the Mercosur trade bloc. They will also present their views on the WTO/Doha Round state-of-play, offer Argentina's support to revitalize NAMA negotiations with the G-22 and look forward to hearing U.S. perspectives from you. You will also have an opportunity to review our developing bilateral trade with

Argentina and address longstanding frictions surrounding U.S. phyto-sanitary barriers to Argentine beef and citrus exports, U.S. anti-dumping duties on honey, and an ongoing ITC anti-dumping investigation on Argentine lemon juice exports.

¶3. (SBU) You will be able to highlight positive developments in our expanding trade relationship, including the two-year renewal of GSP (which benefits roughly 15% of Argentina's \$4-plus billion in exports to the U.S.), close cooperation on the Container Security and Trade Transparency Unit initiatives, our recent announcement that Patagonia (Argentina below the 42nd parallel) may soon be declared foot and mouth disease-free, and our mutual interest in a positive resolution to the GoA's recent WTO case against Brazil for its application of anti-dumping duties on PET-resin exports from Argentina.

¶4. (SBU) Representatives of U.S. Fortune 500 companies in Argentina's agro-industrial, automotive, pharmaceutical, financial services and other sectors will be eager to discuss with you challenges they face operating in an Argentine market that requires them to adapt to sudden changes in regulatory and tax regimes and to inadequate enforcement of intellectual property rights.

¶5. (SBU) Your visit comes at a time of considerable ferment in Argentine political and economic arenas. In October 2005 President Kirchner won a resounding victory in mid-term legislative elections. Based on these results, Kirchner has further tightened his already firm control of political and economic policy. Political interest is focusing increasingly on the October 2007 presidential elections. Argentina finished 2006 with its fourth straight year of strong economic growth, with exports, employment, industrial

production, agriculture and livestock sectors turning in record performances. Over 50% of total Argentine exports are represented by agricultural, livestock, and food shipments, and have been a focus of GOA policies to maintain low domestic prices and increase government revenues. These GoA policies, which include a menu of export tariffs, export quantity controls and explicit and implicit price controls, have introduced significant micro economic inefficiencies to Argentine markets. Nevertheless, Argentina has sustained an impressive economic recovery since suffering the worst economic crisis in its history, including the largest sovereign default in world history and a substantial nominal devaluation of its currency in 2001-02.

¶6. (SBU) Ambassador Veroneau, senior GoA officials understand the need for increased trade and foreign investment to sustain Argentina's economic growth and they have made very clear their interest in re-engaging with you and other USG counterparts on the range of commercial issues. There is also evident Argentine private sector support for enhanced bilateral commercial ties with the U.S. Following your discussions here, GoA Economy and Foreign Ministry officials hope that you will be willing to jointly announce agreement to hold a USTR-hosted Bilateral Commission on Trade and Investment meeting in Washington sometime this spring. Post strongly supports this initiative and, if you concur, looks forward to working closely with your USTR team on this project in the coming months.
END INTRODUCTION AND SUMMARY.

Background

¶7. (SBU) Early in the 20th century, Argentina was one of the richest countries in the world, with a GNP per capita that would have placed it among the G7 of its day. However, the history of Argentina over the last 70 years has been one of economic decline and political instability. Many Argentines are at a loss to explain how their country, blessed with rich natural resources, a fertile land and manageable population numbers, could have fallen so far. Some blame the military

dictatorships which predominated between 1930-1983; others blame Peron's corporatist state and economic model; and a significant number blame external factors: the IMF, the U.S., and, to a lesser extent, Europe, especially following the 2001-2002 economic crisis, the worst in Argentine history. The election of left of center Peronist Nestor Kirchner in 2003 marked a significant shift in Argentine foreign policy, aligning the country more closely with its MERCOSUR and other regional partners such as Venezuela and less closely to the U.S. That said, Kirchner has cooperated with the U.S. on a number of issues, including counter-terrorism and narcotics, peacekeeping in Haiti, promoting stability in Bolivia, and working together at the United Nations.

Political Landscape

¶8. (SBU) Kirchner is widely perceived to be the strongest

Argentine President since the return to democracy in 1983, and he faces a weak and divided opposition. Argentines give Kirchner much of the credit for the country's phoenix-like recovery from its 2001-2002 economic crisis, an event equivalent to (albeit much shorter than) our Great Depression. Political interest is focusing increasingly on next year's presidential elections. It is widely thought that, if he chooses to run, Kirchner will win reelection easily. There has been much speculation, including from president Kirchner himself, that he will not be a candidate and that his wife, Senator Cristina Fernandez de Kirchner, will stand in his place. Declared or potential opposition candidates include former Economy Minister Roberto Lavagna, businessman and president of the famed Boca Juniors soccer team Mauricio Macri, center-left national congresswoman Elisa Carrio, Governor of Neuquen state Jorge Sobisch, and former President Carlos Menem.

¶9. (SBU) Argentina has played a positive role in promoting human rights and democratic institutions in the hemisphere, particularly in Haiti and Bolivia. Along with a number of its neighbors, Argentina currently has 575 peacekeeping troops in Haiti in support of MINUSTAH, reflecting its traditionally strong support of UN peacekeeping operations and commitment to Haiti.

¶10. (SBU) Kirchner's administration has strongly supported counter-terrorism policies, having itself twice been a victim of international terrorist attacks in the early 1990s. The GOA has ratified all of the 12 international counter-terrorism conventions. Argentina is a participant in the Three Plus One regional mechanism, which focuses on possible terrorist-related activity in the Tri-border region between Argentina, Brazil, and Paraguay. On December 20, President Kirchner signed the GoA's long-anticipated draft anti-terrorism and counter-terrorism finance bill and sent it to Congress.

¶11. (SBU) The GOA has been a strong international voice on arms control and nonproliferation issues. On Iran, the GOA voted to refer Iran's noncompliance to the UNSC at the September 24 IAEA Board of Governors meeting. The GOA has also endorsed the Proliferation Security Initiative (PSI).

Argentina's Economy

¶12. (SBU) Argentina has had an impressive recovery since suffering the worst economic crisis in its history in 2001-02, including the largest sovereign default in world history and a 70% nominal devaluation of its currency. A surge in domestic aggregate demand facilitated by GoA fiscal, monetary and income distribution policies, has resulted in real GDP growth in the 8-9% range in each of the past four years, with GDP reaching about \$206 billion at the end of calendar 2006, approximately \$5,300 per capita. The Kirchner

Administration has ably managed the nation's public finances and achieved large budget surpluses. As a result, investors in Argentine financial instruments perceive lower risk levels. Moody's recently upgraded its sovereign credit risk

rating for Argentina to B3 (several levels below investment grade), and Argentina's sovereign country risk premium, as measured by the benchmark JP Morgan Emerging Markets Bond Index, fell to 192 basis points, Argentina's lowest premium since JP Morgan introduced the index in 1992. Industrial and construction activity have been growing rapidly, and tourism has boomed, with a record high of an estimated 4.1 million foreign tourists visiting in 2006. Economic expansion is creating jobs and unemployment dropped from 21.5% during the height of the crisis in 2002, to 10.2% during the third quarter of 2006. Poverty has also fallen from the post-crisis level of 60%, but remains stubbornly high, at about 31% now living below the poverty line.

¶13. (SBU) Argentina negotiated a debt exchange with 76% of its creditors in 2005 (paying roughly 34 cents on the dollar). The government refuses to deal with investors holding approximately 24% of the value of Argentine defaulted bonds (currently totaling about \$25 billion), and many of these holdouts are seeking compensation through U.S. and international courts. Argentina owes approximately \$7.2 billion to Paris Club creditors, including over \$3.5 billion arrears and past due interest. The government has expressed interest in negotiating a debt rescheduling deal with Paris Club creditors. An IMF program is required for the Paris Club to restructure Argentina's debt, and Argentina ceased its IMF program when it paid off its nearly \$10 billion debt to the IMF in January 2006. Nevertheless, informal discussions between the government and Paris Club Secretariat are ongoing. Argentina owes approximately \$360 million to the United States, of which over \$300 is in arrears (including over \$290 million owed to the U.S. Exmibank). Argentina fell under Brooke Amendment sanctions on October 1, 2003, when it fell into arrears on principal payments on a USAID loan. The Brooke Amendment to the Foreign Operations Appropriations Act (FOAA) bans the use of USG assistance under the FOAA to countries more than 12 months in principal or interest arrears on USG loans made under the FOAA. This covers USAID programs as well as assistance under a number of military programs (FMF, MAP, FMS, PKO).

¶14. (SBU) Argentina's impressive recovery, which has led to improvements in key socio-economic indicators, can be attributed to a number of factors. First, following a decade of market reforms in the 1990s, the economy was fundamentally sound except for the high level of indebtedness. Second, the adoption of a more flexible exchange rate regime in early 2002 and the combination of high commodity prices and low interest rates catalyzed an increase in Argentina's exports. Third, strong global and regional growth has also contributed to Argentina's resurgence. Exports are at record levels and Argentina's trade surplus is estimated to have totaled \$11.3 billion in 2006. Foreign trade equaled approximately 38% of GDP in 2006 (up from only 11% in 1990) and plays an increasingly important role in Argentina's economic development. The government has maintained a primary fiscal surplus and continues to accumulate reserves, which reached \$32 billion in January 2007.

¶15. (SBU) Argentina should continue to perform well in 2007 with real GDP growth projected at about 7% and inflation in

the 10-12% range. Nevertheless, the GoA's slowness in addressing public service contract renegotiations, capacity constraints, potential energy shortages in the face of high growth and distorted energy prices, inflation and the government's heterodox policies to contain it (including pressure on the private sector to maintain price controls), and a still-weak investment climate are potential obstacles to attracting the levels of new foreign direct investment

required to sustain the recovery.

Trade Overview and Bilateral GoA/USG Frictions

¶16. (SBU) Argentine trade has grown rapidly following the 2002 economic crisis. Between 2003 and 2006, exports jumped 55% from \$29.6 billion per year to \$45.8 billion; imports jumped over 150% from \$13.8 billion to \$34.5 billion during the same four year period. Despite the more rapid growth of imports, Argentina continues to enjoy a sizable trade surplus: 2006 will be the fifth consecutive year with a trade surplus of over \$10 billion. Because the devaluation of the peso in 2002 significantly lowered GDP in dollar terms, trade as a share of GDP nearly doubled from 17.0% in 2001 to 33.4% in 2002, and rose to 36.8% in 2005

¶17. (SBU) About 50% of 2005 exports fell into the category of agriculture, livestock and food, with over 20% - \$8.2 billion - in soy (soybeans, meal, oil-cake and oil) alone. Brazil is Argentina's top export market by far (15.8% of 2005 exports), and in 2005 was followed by Chile (11.2%), the U.S. (11.2%), and China (7.9%). Imports were concentrated in intermediate and capital goods, with about 41% of the total. Brazil is also Argentina's number one supplier of goods (36.4% of total imports in 2005), followed by the U.S. (15.7%), China (5.3%), and Germany (4.7%). Despite Argentina's burgeoning trade, its share of global exports has fallen since 2002/3, and Argentina's trade surplus, while still large, has shrunk considerably, led primarily by changes in trade with Brazil. Since export taxes on primary product exports contribute significantly to government revenue, any significant drop in international commodity prices would threaten not only Argentina's trade surplus but its fiscal surplus as well.

¶18. (SBU) There remain a number of bilateral frictions in the Argentine/US trade relationship, some of which have lingered for years. Both sides have concerns over beef: Argentine exports to the U.S. have been blocked for some years following a breakout of Foot-and-Mouth Disease, and the GoA complains that the U.S. phyto-sanitary review process is too slow. Exports of U.S. beef and sweetbreads to Argentina have been banned since 2004 by the GoA due to fears of bovine spongiform encephalopathy, and some U.S. firms which import processed beef have been adversely affected by recent beef export limitations. Argentina has been frustrated with slow progress towards permitting imports of Argentine citrus, suspended since 2001 due to citrus canker and pest risks. Both sides are presently watching anti-dumping investigations) one in the U.S. over Argentine lemon juice, and one in Argentina over blank optical compact discs. Argentina is also discouraged by antidumping duties in the U.S. on oil

country tubular goods, which have been in the sunset review status since 2000. Finally, IPR has been a long-standing concern for the U.S., with Argentina on the Special 301 Priority Watch List since 1996, mainly due to general lack of enforcement and an unwillingness to protect confidential pharmaceutical data used to obtain health approval.

Managed Trade in the Auto Sector

¶19. (SBU) Argentina's auto sector, composed entirely of American, European and Japanese players, closed 2006 with its best year since 1998. Ford and GM are prime movers in this sector. Production in 2006 reached 432,000 units, a 35% increase from 2005; new car sales amounted to 460,000 units, a 14% increase from 2005; and exports reached 237,000 units (55% of production is exported), up 30% from 2005. Brazil and Argentina, virtually the only producers in the region, have a complex auto trading regime, and a substantial amount of auto trade. Under their "flex" trading regime in effect until July 2008, for every USD 1.95 of Brazilian duty free

exports of autos and auto parts to Argentina, Argentina can export USD 1 to Brazil duty free. There appears little possibility that free trade in the auto sector will come about any time soon, as Argentina continues to aggressively press for managed trade schemes to protect its industry in the face of Brazil.

Agribusiness

¶20. (SBU) U.S. agribusiness companies have invested heavily in the Argentine economy for many decades and have made major contributions to the agricultural and livestock sectors. Cargill, for example, is making investments valued at \$330 million in agricultural processing facilities (soybeans, malt), a packing house, and port facilities. Over the last two years, business and profitability in this sector have been challenged by GOA intervention exemplified by the ban on exports of fresh meat, price controls imposed on wheat, and the freezing of export sales of corn. Another American firm, Monsanto, faces major challenges, in particular its inability to collect royalties on the Round-Up Ready soybean technology, which has revolutionized soybean production in Argentina. It has attempted to negotiate a solution to this issue with seed companies, farm organizations, and other stakeholders and launched court cases in Europe. Unfortunately, Monsanto and GOA authorities have not found a meeting of the minds to resolve this important issue of intellectual property rights protection.

Agriculture

¶21. (SBU) The agricultural and livestock sectors, two of the mainstays of the Argentine economy (over 50% of total Argentine exports are represented by agricultural, livestock, and food shipments), have been negatively affected by GoA

policies to contain inflation due to their importance in calculating the CPI. The two principal policy initiatives which the GoA has chosen to curb inflation have been through price and export controls, which have affected grains (wheat and corn), dairy, and meat. In 2006, when international wheat prices had sharply increased, the GoA mandated that Argentine exporters sell four million tons of wheat to the milling industry at a price (\$120 per ton) well below the international price, in an attempt to maintain the price of bread at what it considers a "reasonable" level. The GoA has also frozen advance corn export registrations, hoping to ensure sufficient corn for domestic use (the corn is used, in the main, as feed for livestock and poultry, and for food) without putting upward pressure on prices.

¶22. (SBU) In January 2007, the Minister of Economy announced that the GoA would increase export taxes on soy and soy products by 4% to 27.5% and 24% respectively. The GoA expects to collect an extra US \$400 million annually from this export tax increase which it will use to subsidize domestic consumption of wheat, corn and soy. Earlier in 2006, as prices of dairy products rose, the GOA reacted by increasing export taxes on cheese and powdered milk. These taxes undercut previously strong growth by this industry, and led one of Argentina's main dairy cooperatives, which was suffering from heavy indebtedness and low profitability, to seek credits and assistance from the government of Venezuela, which Hugo Chavez promised President Kirchner that he would deliver, but has not yet to date. In 2005, the GOA increased the export tax on fresh beef from 5 to 15%, and the minimum slaughter weight to 280 kilograms. In March of 2006, it banned almost all fresh beef exports (except those destined to fulfill the European Union's Hilton Quota, and those involved in country-to-country agreements). Over the last five months, the GOA has relaxed some of these restrictions, after it realized that market intervention had become

counterproductive. It is, however, again poised to intervene aggressively if it believes that beef prices are increasing at an "unreasonable" rate.

WAYNE